

SEATTLE HOUSING LEVY RENEWAL

1981 - 1986 - 1995 - 2002



FINANCIAL SUSTAINABILITY

A background paper for Levy Renewal discussions

What is Financial Sustainability

Previously Funded Projects

1986 & 1995 Levy Operating & Maintenance Trust Fund Program

2002 Levy OMTF Program

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FINANCIAL SUSTAINABILITY

Summary

□ What is Financial Sustainability?

Financial Sustainability issues relate to keeping what has already been funded AND sustaining viability of new projects, in particular, those serving previously homeless and special needs populations (people who can afford little rent).

□ Previously Funded Projects

- ◆ Levy-funded project replacement reserves are generally sufficient---new Levy funds are not needed for previously funded projects.
- ◆ City needs to be diligent about requiring adequate replacement reserves and monitoring their status.
- ◆ 1981 Seattle Senior Housing Bond Program reserves are in good shape and program rents are generally sufficient to cover operating costs and replacement reserve requirements.

□ 1986 and 1995 Levy Operating and Maintenance Trust Fund Program

- ◆ Program set up to provide ongoing operating subsidy to projects receiving 1986 and 1995 Levy capital funding and serving special needs populations---subsidy provided for up to 20 years, program funding permitting; projects first received funding in 1990---first projects hit 20 years in 2010.
- ◆ Program financial model analysis shows assumptions regarding interest earnings and operating expenses continue to appear reasonable, BUT:
 - *****Very uncertain future:** McKinney support could end, operating costs could increase suddenly (eg. utility costs)---suggests looking at new approaches;
 - *****Expiration dates built into the Operating and Maintenance Trust Fund Program are inherently problematic:** what happens when projects reach their 20 year cut-off point and funding for operating subsidies runs out?? New approaches are needed that ideally do not require periodic funding renewal.

■ **2002 Levy Operating and Maintenance Trust Fund (OMTF) Program**

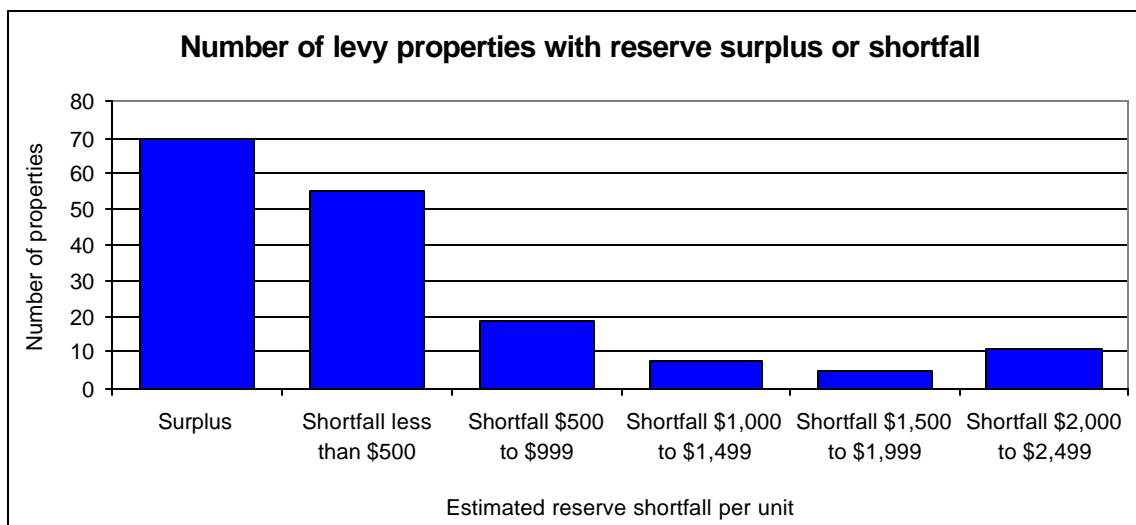
- ◆ Needed to support special needs projects, helping meet the City's affordability policy by combining with other resources to support projects long term (20 years plus).
- ◆ Enhanced Property Management should simply be considered an eligible expense under the OMTF Program.
- ◆ OMTF funding needs to be combined with other resources to provide long term project specific solutions not dependent on future Levies.
- ◆ Other resources to be explored for linkage with OMTF support to provide project-specific solutions based on project characteristics and sponsor capacity:
 1. Section 8 project-based vouchers---vouchers project-based to levy funded projects to provide operating subsidy.
 2. Project funding structured to support agency wide programming.
 3. Using project development funding to capitalize a project specific operating reserve for fixed number of years, to be replaced with eventual increased project rents.
 4. Philanthropic connections---seeking new/additional resources (examples: Gates Sound Families Program, agency private fund-raising).
 5. Look at agency total portfolio to see if revenues (eg. from commercial space where commercial is viable) are available to subsidize units at 0-30% of median.
 6. Incorporating energy efficient materials into projects to help lower operating cost over time.
 7. Challenging service systems to focus greater attention on linkage of services to helping people maintain housing---follow federal efforts mandating closer alliances between HUD and HHS (long term effort).
- ◆ As funding models develop, apply to projects now receiving 1986 and 1995 Levy OMTF funding to avoid the "20 year expiration" problem.

Portfolio assessment: replacement reserves

Dupre + Scott was asked to analyze the 1986 and 1995 levy properties to determine if the current replacement reserves and annual additions to reserves are sufficient? We were also asked to present an appropriate methodology to ensure sufficient long-term reserves.

The graph below shows the current reserve surplus or deficit estimated by our reserve model for each levy property.

- We studied 168 properties for this reserve analysis, which does not include all levy properties, but it is the significant majority of properties, forming a reasonable base for this analysis.
- 98 properties have a lower replacement reserve balance than our model indicates sufficient for 20 years of sustainability. The total reserve shortfall is \$2.94 million.
- Only 24 properties have estimated shortfalls over \$1,000 a unit.
- This analysis assumes each property add a minimum of \$465 a unit a year to reserves beginning in 2002. This is likely more than properties currently contribute.
- The model we use is a useful tool, but it is not a substitute for detailed life-cycle analyses. OH is working with levy property sponsors to complete such detailed analyses. This is an important step.
- Actual annual reserve contributions should be based on the needs identified in comprehensive life-cycle analyses. All future levy properties should determine reserve contributions based on life-cycle analyses. Note: these contributions can be phased, and they can also be supplemented by other revenue sources identified by sponsors, such as refinancing. The important element is the establishment of a realistic plan.
- In addition to the 20-year sustainability analyzed to date, consultant will analyze 30-year and long-term sustainability. The 20-year limit was selected because of two factors: (1) Since most levy properties are already in operation, the 20-year look takes levy properties out 25 to 30 or more years; and (2) sponsors should be able to look to other revenue sources in addition to reserves alone to meet long-term capital needs.

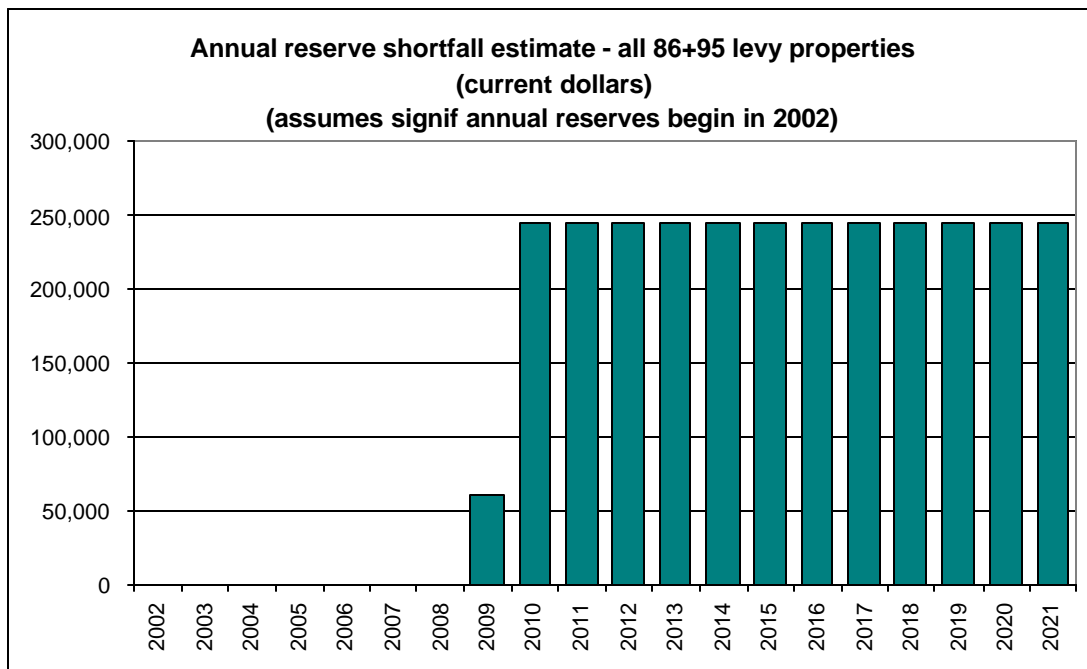


Ensuring sufficient reserves

How should the city deal with situations where reserves and annual allocations going forward are not expected to be adequate?

Options

- Fund expected reserve shortfall from the next levy
- Solve shortfalls through case-by-case workouts, eliminating critical shortfalls with Section 8 support or other resources or actions.



<p style="text-align: center;">Appendix</p> <p style="text-align: center;">Sustainability of replacement reserves for 1986 and 1995 levy properties</p>

Also see [Trust Fund Replacement Reserve Model](#), and Excel spreadsheet

Also see [Replacement Reserve Instructions](#), a PDF file for users of the reserve model.

The Office of Housing has given training on replacement reserves, life-cycle analysis, etc. A number of organizations have provided life cycle cost analyses” to date. These include: SEED, Delridge, CHHIP, and PHG. These organizations provided reports for 25 properties. In addition, LIHI and SCIDPDA indicated they will provide reports for seven properties. For a list of properties, see the section elsewhere in this report, [Life cycle cost analyses](#).

The Office of Housing has a goal of funding replacement reserves as part of operating expenses for each OMTF project.

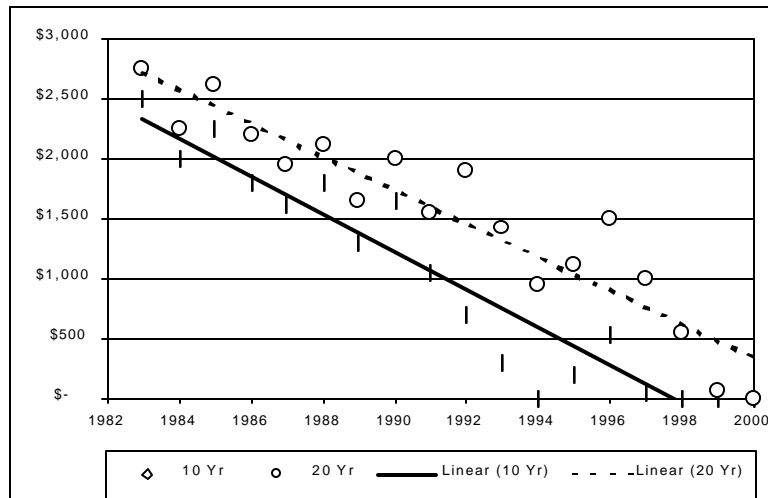
- The actual amount of funded reserves varies.
- The formula is to allocate \$350 a unit toward reserves until 10 years worth of reserves is banked (\$3,500 a unit).

Appendix

Current replacement reserve needs: 1986 + 1995 levy portfolios

- ▶ Levy properties have a replacement reserve account balance of \$6,678,799.41, excluding an extraordinary reserve of \$2,011,461 for Bailey Boushay House. [levy property reserve account balances.xls](#)
- ▶ The replacement reserve averages \$917 a unit for the 7,283 units reported for 207 properties (excluding Bailey Boushay House). Overall, this is a substantial reserve compared to minimal reserves typically carried on private market properties.
- ▶ As a quick comparison, if you use the year the project was completed as an estimate of the property's effective age, the average age in the levy portfolio is 1994. (Data available for 180 of 208 properties.)
- ▶ The 20-year trend line in the graph below shows that a 1994 property should have a replacement reserve of \$1,180 a unit to sustain its capital needs for at least 20 more years. However, this assumes that it adds to reserves annually at the rate of \$465 a unit, increased each year for inflation in costs.
- ▶ We selected the \$465 a unit annual reserve based on a preliminary set of capital components, and their age and cost estimates. The resulting annual replacement reserve provides a new property with at least 30 years of sustainability, based on assumptions about inflation and interest rates. [Reserve Analysis.xls](#)
- ▶ Sustainability beyond 30 years requires a significantly larger reserve. We have chosen to limit our time frame for a variety of reasons. These include: (a) the optimal analysis will be based on a thorough life cycle analysis for each property; (b) after 30 years the property may be able to meet some of its capital needs through refinancing, particularly when the original loan has been paid off.
- ▶ One issue is the disposition of replacement reserves when tax credit properties sell after 15 years.

Current replacement reserve needs based on property age



Operating & Maintenance Trust Fund Sustainability

Dupre + Scott was asked to analyze the 1986 and 1995 Operating & Maintenance Trust Funds (OMTF) to determine if the trust funds were sustainable over the 20-year commitment periods for each trust fund property.

These funds were designed to support operating cost shortfalls for specific properties providing housing affordable to households at or below 30% of median income. OMTF support is being provided to approximately 600 units. This support does not pay for all operating costs, since trust fund properties receive rental income and/or additional financial support subsidies from other sources.

Scenario 1: Trust fund sustainability

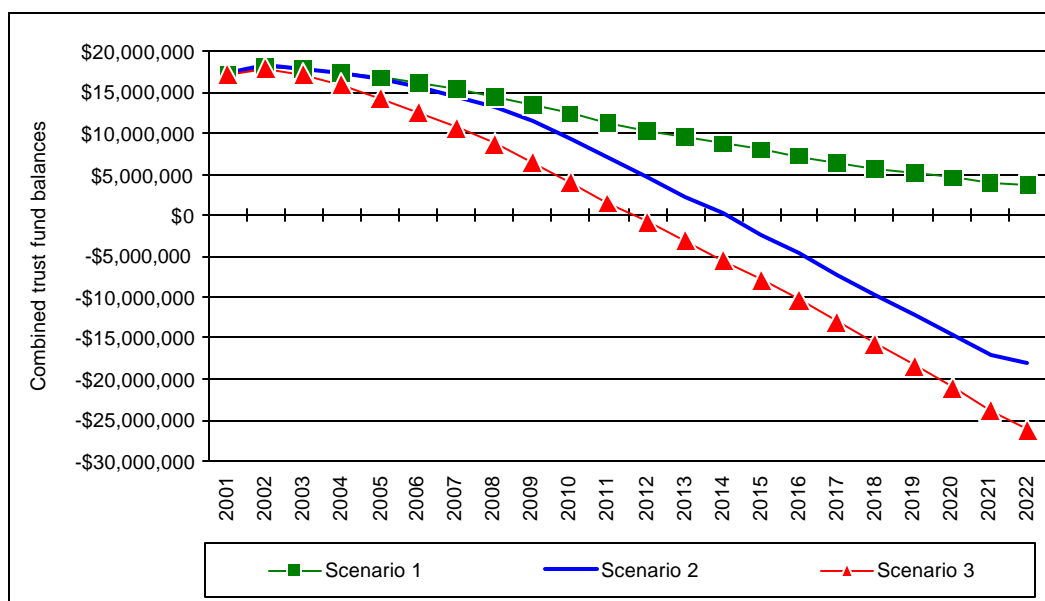
This projection is based on a review of actual increases in annual trust fund support for each trust fund property. We conclude that the trust fund is sustainable over the 20-year commitment period established for each trust fund property, based on the assumptions about portfolio size and continued funding from other subsidy sources. This scenario results in an ending positive balance of \$3.8 million. However, that represents just over \$300 a unit a year over the projection period, making it more useful as a contingency fund than anything else.

Scenario 2: Portfolio sustainability

This analysis assumes subsidy from other sources is frozen at current levels. Since operating costs generally increase each year, such a scenario would shift the full burden of those increases to the trust fund. As a result, our projection estimates the trust funds will be exhausted by 2015. As a result, although the trust fund appears to be sustainable over its period of commitments, the portfolio itself has significant risks resulting from funding reliance on other subsidy sources. There is a risk of loss of other subsidy sources, which would be more damaging than the assumptions in this scenario.

Scenario 3: Portfolio expansion

This scenario considers the impact of expanding the size of the portfolio supported by the 1986 and 1995 trust funds. It adds 100 units a year over four years, and then maintains support for those units, plus the original portfolio, through 2011. Fewer than 50 units could be added to the trust funds and maintain funding through the 20-year commitments. However, even this assumes no loss of other funding sources, lower than average initial subsidy levels, and exhausting the reserve balances. This scenario shows the existing trust funds cannot support more than minimal additions, and at some risk to the overall trust fund.

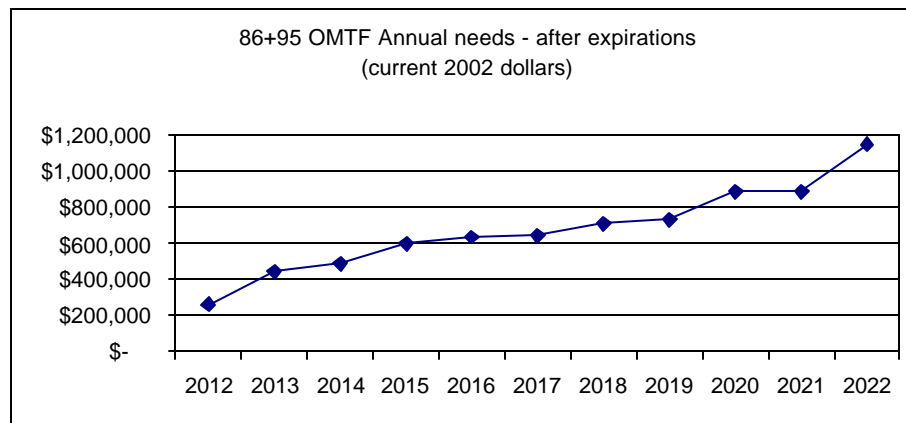


Trust fund “reservation” period

The Seattle City Council originally established the 20 year “reservation” time period for the 1986 levy, and it was used again for the 1995 levy.

Our analysis of the operating trust fund shows that it is sustainable for the original 20-year commitments. This analysis assumes trust fund support for each eligible property ends after 20 years. As a result, support for properties funded by the 1986 and 1995 trust funds will begin expiring between 2012 and 2022.

- Trust fund support for existing properties remains intact through a new levy period, estimated as 2002 through approximately 2009.
- The graph below shows the annual cost to continue trust fund support after the initial 20-year commitments. It would cost \$7.4 million in today’s dollars to extend support for all current properties through 2022.
- This account could be capitalized today for something less than \$7.4 million, but it is likely most interest income earned will be offset by operating cost increases over the same time period. Even an optimistic scenario using 5% interest earnings on the capitalized account with only 3% annual cost increases requires \$5.5-million today.



Is a 20-year reservation period still the appropriate time frame for a new levy to consider?

Options

- Operating subsidy ends at 20 years for current and future trust fund properties.
- Use a new time period tied to each project’s capital fund source, for new properties.
- Identify funding sources to extend operating subsidy for current projects beyond the initial 20-year period.

Alternatives to use of the trust fund

The analysis for this report indicates the trust fund is sustainable over the 20-year reservation periods established for each trust fund property. However, continuing subsidy beyond the 20-year reservation period is not sustainable with current financial resources. In addition, there is a funding risk within the trust fund portfolio (Scenario 2, page 1 of this report) even during the 20-year reservation period. Because of these issues, it would be worthwhile to consider alternatives to use of the trust fund.

ALTERNATIVES

1. **Capitalize OMTF.** Allocate specific levy proceeds to eligible properties to establish individual trust fund accounts.
2. **Sec. 8.** Use Section 8 Project Based subsidy.
3. **Internal subsidy.** Rely on internal project subsidy.
4. **Temporary subsidy.** Provide temporary trust fund support for projects with longer-term self-sufficiency plan.

CASE STUDY SUMMARY OF ALTERNATIVES

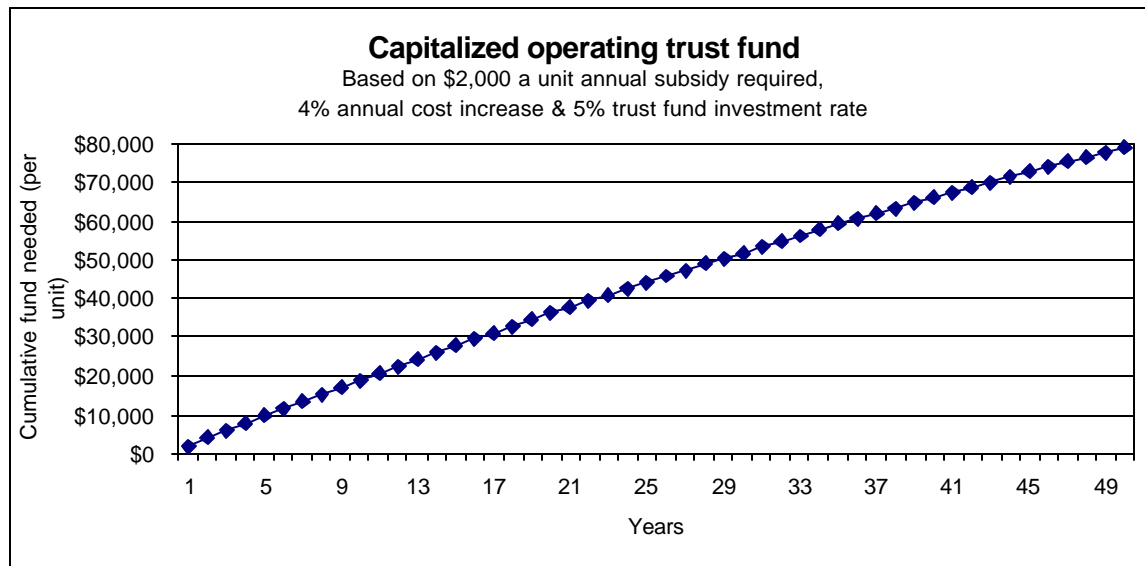
The funding costs for these alternatives are summarized below, based on an estimated total portfolio of 375 units. This analysis uses an annual OMTF need of \$2,000 a unit (current dollars). The four alternatives shown here provide a foundation for a number of other alternatives that combine features of two or more alternatives.

1. **Capitalize OMTF for 20 years**
 - a. **Cost.** \$13.6-million required from levy in year 1, or \$2.35-million a year over a 7 year levy period for a total commitment of \$16.45-million. (Per unit cost: \$31,500 in year 1, or \$5,450 a year over 7 years, for a total commitment of \$38,150 a unit)
 - b. **Other factors.** This alternative contains the same 20-year reservation limitation. The detailed analysis that follows shows costs for shorter or longer reservation periods.
2. **Section 8 project based subsidy**
 - a. **Cost.** No levy-funded cost. Cost to Section 8 program = \$750,000 a year, or \$167 a unit a month (current dollars).
 - b. **Other factors.** This alternative's viability depends on its fit with the goals of the Section 8 program as well as Section 8's long-term funding prospects. Subject to those constraints, however, there is no 20-year reservation limit.
3. **Internal subsidy.**
 - a. **Cost.** No levy funded cost.
 - b. **Other factors.** This alternative requires a significant number of additional units renting to households above 30% of median income. This alternative also creates housing affordable at or below 30% of median income slowly over a number of years.
4. **Temporary subsidy.**
 - a. **Cost.** \$10.125-million required in year one, or \$1.75-million a year over a 7 year levy period for a total commitment of \$12.25-million.
 - b. **Other factors.** The primary drawbacks of this alternative are significantly front-loaded subsidy requirements and a significant number of units needed renting to households earning more than 30% of median income. The primary benefit is at self-sufficiency could be secured for traditional trust-fund type units within approximately 15 years.

Alternatives to use of the trust fund: Capitalize operating reserves for each project

The graph below shows the amount that would have to be set aside today to capitalize a trust fund covering one unit of housing for as long as 50 years. This is a relatively optimistic scenario, since it is based on an annual subsidy of only \$2,000 a unit and a positive spread between interest earnings and operating cost increases.

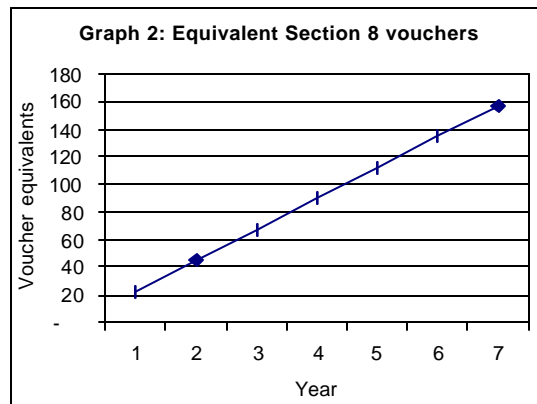
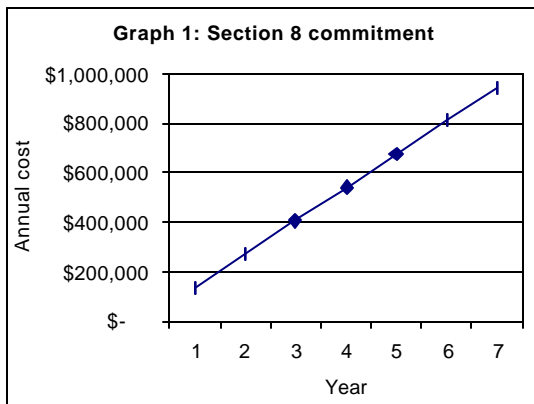
- Based on this scenario, a trust fund would have to be capitalized with \$19,000 today to support one unit for 10 years, \$36,000 for 20 years of support, or \$66,000 for 40 years of support.
- If a new levy results in 375 eligible trust fund units, the capitalized trust fund today would need to be \$7.1 million for 10 years, \$13.6 million for 20 years, or \$24.8 million for 40 years.



Alternatives to use of the trust fund: Section 8 project-based support

This alternative could be viable if the type of units traditionally eligible for trust fund support fit the goals of the Section 8 program, and if the cost to support those units does not impact other goals of the Section 8 program.

- **Individual monthly voucher cost.** If trust fund properties currently require average support between \$2,000 and \$2,500 a unit a year, this compares to a Section 8 voucher cost to Seattle Housing Authority (SHA) of between \$167 and \$208 a unit a month.
 - It would be worthwhile to compare this cost per voucher to the typical cost incurred by SHA to determine if this is a comparable or cost-effective option.
- **375 unit annual portfolio cost.** Based on a \$2,500 annual cost to support a trust fund unit, it would cost SHA almost \$940,000 a year to support a 375 unit portfolio.
 - Graph 1 shows the cost would likely be phased in over the seven year levy period. If trust fund properties were developed evenly over the seven years, Section 8 subsidy would begin at \$135,000 in the first year and increase by that amount annually until it reached \$940,000 a year.
 - Graph 2 estimates the tradeoff that would take place between traditional Section 8 vouchers and trust fund units. In this example we estimated the typical cost to SHA of a Section 8 voucher at \$500 a unit a month, compared to a cost of \$208 a unit a month to support each trust fund unit. Basically, the cost to fund one typical voucher could support 2.4 trust fund units in this example.



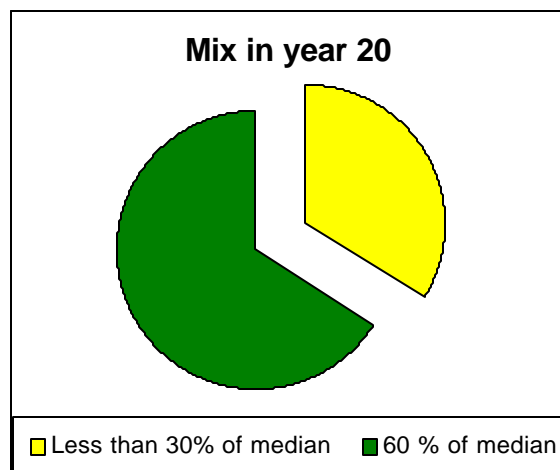
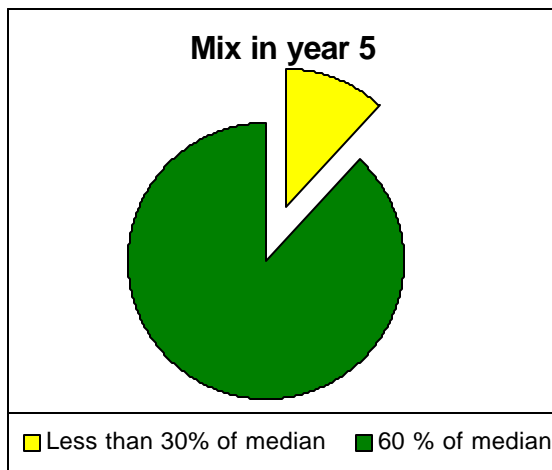
Alternatives to use of the trust fund:

Rely on internal project subsidy

The graph below shows the result of an income and expense model created to estimate the capability of internal project subsidy. The model results will vary depending on assumptions used.

In this example, a 100-unit development renting to households at 60% of median income could not initially afford to rent any units at levels affordable to households at 30% of median income. Over time, however, some of the project's units could rent to those households. This example estimates that in year 5, 12 units could be rented at rents affordable to households earning 30% of median income. By year 20, we estimate 34 units could rent at levels affordable to households earning 30% of median income.

- This example is based on rents at 30% of median income. If the property were trying to rent units to as many households as possible, earning no more than 30% of median income, then it is likely the average income of those households will be below 30% of median. If the average income of those households was 20% of median, and rents were affordable to those households, the property could support 16 units by year 10 and 35 units after year 30.



Alternatives to use of the trust fund: Provide temporary support

The graph below shows the monthly subsidy estimated if a 100-unit development rents 80 units affordable to households earning 60% of median income and 20 units to households earning an average of 20% of median income (with a range of 0% to 30%).

- In year one, subsidy for each of the 20 units is \$400 a month. No subsidy is required beginning in year 14.
- The average monthly subsidy over the 13-year subsidy period is \$208 a unit a month.
- The cumulative subsidy over the 13 years is \$32,000 a unit.
- The trust fund amount needed today, earning 5% interest, to fund the required annual subsidy is \$27,000 a unit.

